

# Retail investment funds in Germany: regulatory overview

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A Q&A guide to retail investment funds law in Germany.

This Q&A provides a high level overview of retail investment funds in Germany. Areas covered include: a market overview; a description of how interests in funds are accessed and priced; fund vehicles and structures; key statutes, regulations and rules governing funds; applicable local or state laws; authorisation requirements for retail funds; rules governing managers and operators; marketing; the assets portfolio; investment and borrowing restrictions; redemption of interests; reporting requirements; tax treatment; and reform.

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## Market structure

1. What is the structure of the retail funds market? What have been the main trends over the last year?

Retail funds are subject to the product and marketing rules set out in the German Capital Investment Code (*Kapitalanlagegesetzbuch*) (KAGB). Funds are either open-ended or closed-ended. An open-ended fund can be either an:

- Undertaking for collective investment in transferable securities (UCITS) investment fund under Directive 2009/65/EC on undertakings for collective investment in transferable securities (UCITS IV Directive).
- Alternative investment fund (AIF) (a fund that is not a UCITS), where investors have the right to request that their units or shares are repurchased or redeemed out of the fund's assets before the commencement of the fund's liquidation phase or wind-down in accordance with Article 1, paragraph 2 of delegated Regulation (EU) No 694/2014 with regard to regulatory technical standards determining types of alternative investment fund managers.

All other funds are closed-ended funds.

The KAGB defines the investment vehicles and fund types that can be used to set up a German retail fund. An exemption from these requirements is only possible for closed-ended funds and in very limited circumstances, for example if the management company of a closed-ended retail fund falls below certain thresholds.

Retail funds must be marketed under a certain fund category (for example, "equity fund", "fixed-income fund", and so on) if, under the fund terms, more than 50% of the value of the fund is at all times invested in the asset that defines the fund category. For example:

- For equity funds: more than 50% in equity.
- For fixed-income funds: more than 50% in fixed income products.

The category "money market fund" can only be used if the fund complies with the requirements of Regulation (EU) 2017/1131 on money market funds. For exchange-traded fund (ETFs), see [Question 9](#).

The German fund industry recorded significant new business in 2020, in particular in the open-ended fund sector. Investors favoured equity and money market funds. ETFs accounted for almost half of the inflows of open-ended retail funds (*BVI, Statistic Summary, ed. 12/2020, 15 December 2020, p. 1 and 3*). The sustainable fund market is seen as the most dynamic business line of asset management (*BVI, HOW FAR IS THE SUSTAINABLE FUND MARKET IN EUROPE?, 14 December 2020, p. 32*). By the end of September 2020, sustainable ("green") retail funds had more cash inflow than non-sustainable products (*BVI, Statistic Summary, ed. 12/2020, 15 December 2020, p. 8*).

## Open-ended retail funds

A German open-ended retail fund must be set up as a UCITS or retail AIF (*see above*). Four types of open-ended retail AIFs are allowed:

- Mixed investment funds.
- Other investment funds.
- Fund of hedge funds.
- Real estate contractual funds.

UCITS funds can only invest in accordance with the UCITS IV Directive. Retail AIFs can, depending on their type, also invest in:

- Precious metals.
- Unsecuritised loan receivables.
- Derivatives.
- Hedge funds.
- Real property.

See [Question 13](#).

## Closed-ended retail funds

Closed-ended retail funds can only invest in certain asset classes (*see Question 13*). Investments in open-ended funds are not allowed.

2. How are interests in the open and closed-ended funds accessed and priced?

## Open-ended funds

The value of fund interests is calculated based on the net asset value (NAV) of the fund. The issue price is equal to the NAV per share or unit plus the subscription fee (if any). The redemption price is equal to the NAV per share or unit, less the redemption fee (if any).

Orders for the purchase or redemption of fund interests are priced by the management company after market close based on the NAV determined at the issue or redemption date specified in the investment guidelines. Fund interests that are traded on a stock are priced at the current market value, which may vary from the NAV per share or unit.

The purchase of fund interests is processed through the investor's securities deposit. Orders can be placed with the management company of the fund, the investor's depository bank or other licensed financial intermediaries.

## Closed-ended funds

**Closed-ended investment limited partnership.** The issue price for a limited partner interest is equal to the investor's subscribed capital commitment plus the subscription fee (if any). The value of the limited partner interest is based on the NAV of the fund.

Subscription documents can be obtained from the fund's management company or licensed financial intermediaries.

**Investment stock corporation with fixed capital.** Shares are issued as par-value shares or no-par value shares. The issue price is equal to the nominal share value or, in case of no-par value shares, equal to the share's portion of the share capital plus the subscription fee (if any). The value of the shares is based on the NAV of the fund.

The purchase of shares is processed through the investor's securities deposit. Orders can be placed with the management company of the fund, the investor's depository bank or other licensed financial intermediaries.

3. Are there any other retail fund options not mentioned in *Question 1*?

Closed-ended retail funds managed in accordance with an exemption can be set up as unregulated vehicles and fund types. Depending on which exemption applies, certain KAGB requirements remain applicable, for example, with regard to:

- The manager's organisational and management duties.
- Marketing permissions.
- Investment restrictions.

## Fund vehicles and structures

4. What are the main legal vehicles used to set up a retail fund and what are the key advantages and disadvantages of using these structures?

### Open-ended retail funds

**Legal vehicles.** An open-ended retail fund must be set up as either a:

- **Contractual investment fund (*Sondervermögen*).** The contractual investment fund is the primary legal structure used for establishing open-ended retail funds in Germany. It constitutes a pool of segregated assets without legal personality. Investors acquire no-par value units, which are typically issued in bearer form and represented by global certificates held in custody by a central securities depository.
- **Investment stock corporation with variable capital (*Investmentaktiengesellschaft mit veränderlichem Kapital*).** The investment stock corporation with variable capital is a special form of the German stock corporation. The amount of share capital is equal to the corporation's NAV (that is, "variable"). Investors acquire non-voting no-par value shares (investment shares). Shares are typically issued in bearer form and represented by global certificates held in custody by a central securities depository.

Both vehicles can be set up as an umbrella fund with sub-funds. Units or shares can be divided into unit or share classes with different features. Units and shares are transferable securities and are negotiable on a stock exchange. Open-ended retail funds that invest in real estate can only be launched as contractual investment funds.

**Advantages/disadvantages.** No tax related advantages or disadvantages exist when comparing both vehicles, as the tax treatment of contractual and corporate funds is identical (see [Question 17](#)).

The ongoing administrative costs of an investment stock corporation can be higher than those of a contractual investment fund due to the requirements resulting from the legal form of a stock corporation, for example, with regard to the mandatory establishment of a supervisory board. A disadvantage of the investment stock corporation is that it cannot invest directly in real property.

### Closed-ended retail funds

**Legal vehicles.** Unless an exemption applies (see [Question 3](#)), a closed-ended retail fund must be set up as either a:

- **Closed-ended investment limited partnership (*Geschlossene Investmentkommanditgesellschaft*).** Investors can invest directly by becoming a limited partner. Investors must be registered as limited partners in the German Commercial Register. Retail investors can also invest indirectly in the fund through a limited partner in trust/trustee, in which case only the limited partner in trust is registered with the Commercial Register. The trustee manages the limited partner interests on behalf of the investors and represents them in the shareholders' meeting.
- **Investment stock corporation with fixed capital (*Investmentaktiengesellschaft mit fixem Kapital*).** This is a special form of German stock corporation. Investors acquire shares and all shares are voting shares. As the share capital of the investment stock is fixed, shares can be issued as par-value shares or no-par value shares. Shares can be issued in registered or in bearer form.

Both vehicles can be set up as an umbrella fund with sub-funds. Interests or shares can be divided into interest or share classes with different features.

**Advantages.** The advantages of closed-ended retail funds are as follows:

- **Closed-ended investment limited partnership:**
  - an investment limited partnership is easier to set up than an investment stock corporation, and administrative costs are lower;
  - issuing indirect interests allows admitting a higher number of retail investors, in particular if fund interests are offered by means of a public offering, as it avoids having to register every investor as limited partner in the Commercial Register;
  - the partnership has tax transparency and avoids an additional level of taxation, allows for the applicability of the general 95% or 40% tax exemption for capital gains at the level of corporate or individual business investors respectively, and allows tax-exempt repayments of capital.
- **Investment stock corporation with fixed capital:**
  - investors do not have to be registered with the Commercial Register;
  - shares are transferable securities and negotiable on a stock exchange. Shares are booked in a securities account and can be accessed digitally;
  - the special tax regime under the German Investment Tax Act may be advantageous in certain cases due to the limited tax liability of the fund and the partial tax exemptions at investor level, depending on the type of investors and the fund's asset composition (*see Question 17*).

**Disadvantages.** The disadvantages of closed-ended retail funds are as follows:

- **Closed-ended investment limited partnership:**
  - limited partner interests are not negotiable on a stock exchange;
  - the subscription of a limited partner interest is processed through subscription documents, and interests cannot be accessed digitally;

- the German partnership may trigger tax filing obligations for non-German investors if the fund qualifies as carrying on a trade or business.
- **Investment stock corporation with fixed capital:**
  - changes to the share capital of the investment stock corporation with fixed capital are subject to the formal requirements of the Stock Corporation Act;
  - the requirements of Regulation (EU) 1129/2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market (Prospectus Regulation) apply;
  - the special tax regime under the German Investment Tax Act may apply, which, among other things, provides for an additional layer of taxation at the level of the fund, excludes the applicability of certain general tax exemptions for capital gains at investor level, and allows tax-exempt repayments of capital.

German closed-ended retail funds are typically set up as a partnership. No German closed-ended retail fund has successfully been set up as investment stock corporation with fixed capital under the KAGB to date.

## Regulatory framework and bodies

### Key statutes, regulations and rules

5. What are the key statutes, regulations and rules that govern retail funds? Which regulatory bodies regulate retail funds?

### Regulatory framework

The main piece of legislation is the KAGB, which, along with the regulations adopted under it, transposes the UCITS IV Directive and Directive 2011/61/EU on alternative investment fund managers (AIFM Directive) into German law. In addition, delegated Regulation (EU) 231/2013 on exemptions, general operating conditions, depositaries, leverage, transparency and supervision (AIFM Deregulated Regulation) applies to the management of retail AIFs with regard to:

- Exemptions.
- General operating conditions.
- Depositaries.
- Leverage.

- Transparency.
- Supervision.

## Regulatory bodies

Retail funds and their management companies are subject to the supervision of the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*) (BaFin).

## Local or state legislation

6. Within the jurisdiction, are there local state, provincial or similar laws that could apply to retail funds?

Except to the extent permitted by the KAGB, management companies are prohibited from engaging in activities on behalf of their funds that could be licensable under local laws. Retail funds in particular can become subject to German licensing requirements for engaging in banking business, for example, by granting loans or engaging in deposit-taking business. Granting loans is not permitted for German retail funds, with certain exemptions for real estate contractual funds and closed-ended funds (*see Question 13*). EU or foreign retail funds granting loans in Germany are exempt from German licensing requirements, provided they have been approved for marketing to retail investors in Germany. Engaging in deposit-taking business in Germany is prohibited for German, EU and foreign funds.

## Authorisation/licensing of funds

7. Do retail funds themselves have to be authorised, licensed or registered?

BaFin must approve the following in relation to German retail funds:

- Investment guidelines (*Anlagebedingungen*).
- Articles of association or partnership agreement (where applicable).
- Depositary bank.

Approval is also required for any subsequent major changes to these.

If the fund is set up as an investment stock corporation or partnership, the suitability of the members of the fund's management body and, if applicable, supervisory body, is assessed by BaFin through a "fit and proper" test. BaFin is granted an assessment period of four weeks.

For retail AIFs, investors cannot be admitted to the fund before marketing approval has been obtained for the fund, which requires a separate procedure (*see Question 10*).

For open-ended funds, changes to the investment guidelines amending the fund's investment principles only become effective if the management company has offered investors to redeem their shares or units or, if possible, to exchange them for shares or units of another fund managed by the management company that has comparable investment principles, without additional costs.

For closed-ended funds, changes to the investment guidelines that relate to costs or key investor rights, or amend the fund's investment principles, only become effective on the consent of a qualified majority of investors holding cumulatively least two-thirds of the subscribed capital.

Different requirements apply to foreign retail funds in relation to marketing to German investors (*see Question 10*).

## **Authorisation/licensing of managers/operators**

8. Do the operators of retail funds have to be authorised, licensed or registered? What are the key requirements that apply to managers and operators of retail funds?

## **Authorisation/licensing/registration requirements**

Generally, German retail funds must be managed by a Germany-based management company licensed by BaFin. If an exemption from the licensing requirement applies, the management company must still register with BaFin.

German managers of UCITS must be licensed by BaFin as a UCITS management company, while German managers of retail AIFs must be licensed as Alternative Investment Fund Managers (AIFMs).

Managers that manage both UCITS and retail AIFs can acquire both licences. The licensing requirements are based on the requirements set out in the UCITS IV Directive and AIFM Directive respectively. The requirements apply equally to managers of open-ended funds and closed-ended funds, regardless of whether the management company intends to manage German or foreign funds. To acquire a licence, the management company must (among other things):

- Have sufficient own funds.



- Have at least two managing directors who are sufficiently experienced in the management of retail funds and the asset classes concerned.
- Establish and maintain internal control procedures.
- Ensure adequate risk management.
- Establish and apply a remuneration policy in line with the requirements of the UCITS IV Directive or AIFM Directive respectively.

Applicants for a licence must submit to BaFin evidence that these requirements are met, including fit and proper tests for their managing directors and information about the applicant's major shareholders. BaFin is granted an assessment period of six months in total to decide on the application.

While German UCITS can be managed by an EU UCITS management company licensed in another EU member state, an EU AIFM licensed in another EU member state is not permitted to manage German retail funds, nor is any other foreign manager. However, management companies of German retail funds can delegate the fund's portfolio management to foreign managers under the conditions set out in the UCITS IV Directive or AIFM Directive respectively.

### **Other key requirements**

A management company managing a contractual investment fund or, where the management company is a legal entity separate from and appointed by the fund, a fund that is set up in the form of corporation or partnership (external management company) must:

- Be set up as stock corporation, limited liability company or limited partnership whose general partner is a limited liability company.
- Establish a supervisory board, of which at least one member must be independent of the management company.

### **Active and passive management**

9. Are the different types of retail funds typically actively managed or passively managed? Or can they be either?

Index-tracking funds are typically passively managed funds. The majority of index-tracking funds are set up as ETFs. BaFin has incorporated the guidelines of the European Securities and Markets Authority (ESMA) on ETFs and other UCITS issues of 1 August 2014 (*ESMA/2014/937*) (ESMA guidelines) into its supervisory practice with regard to both UCITS and open-ended AIFs. Accordingly, ETFs are regarded as actively managed if the fund manager has

discretion over the composition of the fund's portfolio (and typically tries to outperform an index), whereas ETFs that track an index and where the fund manager does not have such discretion are regarded as passively managed.

## Marketing of funds

### 10. Who can market retail funds?

Generally, a fund can only be marketed to German investors if the fund's management company has obtained the required marketing approval from BaFin or, where applicable, completed the required notification procedure with the competent authorities of the fund's home state.

German UCITS management companies and AIFMs can market the funds they manage to German retail investors in accordance with their management licence, which also covers marketing activities. The same applies to EU and foreign management companies in relation to the funds they manage. However, providing investment recommendations to prospective investors in the form of investment advice is not covered by the management licence.

Distributors intending to market funds to German investors must obtain a German licence for the relevant marketing activity (such as reception and transmission of orders or investment advice). EU distributors can market funds to German retail investors without having to obtain a German licence if they operate under the European passport regime under Directive 2014/65/EU on markets in financial instruments (MiFID II), which covers marketing activity.

Distributors domiciled in a third country can only market funds to German investors if they have:

- Established a branch or subsidiary in Germany that holds a German licence for the relevant marketing activity.
- Successfully applied for an exemption from the German licensing requirement.

## Open-ended retail funds

**UCITS.** EU UCITS can be marketed to German retail investors if the fund has been notified for marketing in Germany to the competent authorities of the fund's home member state under the European marketing passport regime of the UCITS IV Directive.

BaFin may enter into an equivalence agreement with competent authorities of a third country to allow foreign AIFs that are established and managed in the third country in accordance with the requirements of the UCITS IV Directive to be marketed to German investors based on the principles of the European marketing passport regime of the UCITS IV Directive. BaFin has entered into such AN agreement with the Swiss Financial Markets Authority FinMa in relation to Swiss securities funds.

**Retail-AIFs.** EU-based AIFMs and third-country AIFMs intending to market AIFs to retail investors in Germany must obtain marketing approval from BaFin. Marketing approval will only be granted if, among other things:

- The manager and the fund are established in the same EU member state or third country.
- The manager fully complies with the requirements of the AIFM Directive.
- A German representative has been designated to assume compliance tasks in relation to the management and marketing of the fund.
- The fund essentially complies with the German product rules for retail funds.

Given these requirements, third-country funds are seldom marketed to German retail investors. According to the BaFin investment fund database, all of the non-German AIFs currently registered for marketing to retail investors in Germany are either based in the EU or Switzerland.

### Closed-ended retail funds

See above, [Open-ended retail funds](#).

11. To whom can retail funds be marketed?

The KAGB distinguishes between three investor categories:

- **Professional investors.** This category refers to investors qualifying as professional clients under Annex II of MiFID II (professional clients and elective professional clients).
- **Semi-professional investors.** This category was introduced by the German legislator and includes:
  - investors intending to invest at least EUR10 million in a particular fund;
  - investors who intend to invest at least EUR200,000 in a particular fund and satisfy certain additional criteria concerning their knowledge and experience with regard to the intended investment;
  - for investment in a fund managed by an AIFM, members of the senior management, risk takers and members of the control functions, as well as employees that receive a total remuneration that takes them into the same remuneration bracket as senior management and risk takers;
  - for investment in a fund set up as stock corporation or limited partnership, the members of the fund's management board or general partner;
  - certain public sector investors.
- **Retail investors.** These are investors who do not qualify as professional or semi-professional investors.

A retail fund is a fund that can admit any category of investor under its fund terms, including retail investors, and is not restricted to professional and semi-professional investors.

## Assets portfolio

12. Who holds the portfolio of assets? What regulations are in place for its protection?

## Open-ended retail funds

Contractual investment funds do not have legal personality. Their assets are owned either by the management company, in which case the management company acts as trustee for the investors, or by the community of investors. The assets of the contractual investment fund must be kept separate from the management company's own assets.

Assets of a fund set up as an investment stock corporation are owned by the fund.

The main instrument of protection for fund assets is the mandatory appointment of a depositary, which must comply with the requirements set out in the UCITS IV Directive or AIFM Directive respectively. The depositary:

- Holds in safe custody the fund's financial instruments.
- Verifies the fund's ownership title with regard to assets that cannot be held in custody.
- Controls whether the fund's transactions comply with legal requirements and the fund's investment guidelines.

## Closed-ended retail funds

Assets of a fund set up as investment stock corporation or limited partnership are owned by the fund. A depositary must be appointed for the fund to protect the fund's assets (*see above, [Open-ended retail funds](#)*).

## Investment and borrowing restrictions

13. Are there any investment or diversification restrictions for retail funds? If so, what are they?

## Open-ended retail funds

UCITS are subject to the investment restrictions set out in the UCITS IV Directive. The investment restrictions for UCITS therefore also apply to retail AIFs, unless set out otherwise in the provisions for the respective fund type. The restrictions are as follows:

- **Mixed investment funds.** In addition to investments in assets eligible for UCITS, as specified in the KAGB, mixed investment funds can invest in units or shares of:
  - mixed investment funds and other investment funds; or
  - comparable EU or foreign funds.

Further derogations from the UCITS provisions apply.

- **Other investment funds.** These can, in addition to investments in assets eligible for UCITS and mixed investment funds, invest up to:
  - 30% of the value of the fund in precious metals, derivatives and unsecuritised loan receivables;
  - 95% of the value of the fund in unsecuritised loan receivables of or against regulated microfinance institutions;
  - 75% of the value of the fund in unsecuritised loan receivables of or against unregulated microfinance institutions.

Microfinance institutions are enterprises with the main activity of granting cash loans to small and very small entrepreneurs for entrepreneurial purposes.

Further derogations from the UCITS provisions apply, for example, in relation to securities lending and repurchase transactions.

- **Funds of hedge funds.** These can invest in German hedge funds or comparable EU or foreign funds (target funds). Investments in a single target fund are limited to 20% of the value of the fund. Investments in more than two target funds of the same issuer or manager are not permitted. Funds of hedge funds can invest up to 49% of the value of the fund in other liquid assets.
- **Real estate contractual funds.** These can invest in real estate, including real estate companies. The value of a single piece of real property cannot exceed 15% of the value of the fund at the time of acquisition. The total value of all pieces of real property the individual values of which exceed 10% of the value of the fund cannot exceed 50% of the value of the fund. Investment restrictions also apply to participations in real estate companies.

Loans can be granted to a real estate company in which the fund holds participation, up to a total of 50% of the value of real estate held by that real estate company. The total amount of loans granted to such real estate companies is limited to 25% of the value of the fund. Loans taken up are not deducted in the calculation of the values.

Real estate contractual funds can hold liquid assets up to 49% of the value of the fund, of which an amount corresponding to at least 5% of the value of the fund must be held available for the redemption of units.

The value of the fund's assets that is subject to currency risk is limited to 30% of the value of the fund.

## Closed-ended retail funds

The eligible assets for closed-ended retail funds are:

- Real assets, such as:
  - real estate;
  - ships and aircrafts;
  - facilities for production of electricity, gas or heat from renewable energies;
  - rail vehicles;
  - electric mobility vehicles;
  - containers and infrastructure used for real assets.
- Participations in public–private partnership (PPP) project companies.
- Interests in companies that can only acquire real assets or assets required for the management of such real assets.
- Interests in non-listed companies.
- Participations in German closed-ended retail AIFs or comparable EU or foreign closed-ended retail AIFs.
- Participations in German closed-ended special AIFs, European venture capital funds (EuVECA funds) or European social entrepreneurship funds (EuSeF funds), or comparable EU or foreign closed-ended special AIFs.
- Securities, money market instruments or cash.
- Money loans, if granted to entities in which the fund holds an interest and subject to certain restrictions.

Derivatives can only be acquired for hedging purposes.

Closed-ended retail funds must comply with certain investment restrictions, in particular:

- Blind pool strategies are not permissible. Investment criteria must be set out in the fund's investment guidelines for at least 60% of the invested capital at a level of detail specified by BaFin.
- The fund must be invested in accordance with the principle of risk diversification no later than 18 months after the start of distribution. Exemptions are possible in limited cases. Risk diversification is complied with if:
  - at least three pieces of real assets are acquired and the shares of each piece in relation to the subscribed capital calculated on the basis of the amounts that are available for investment after deduction of all costs borne by the investors are essentially evenly spread; or

- a diversification of default risk is ensured from a commercial point of view.
- The value of the fund's assets that can be subject to currency risk is limited to 30% of subscribed capital calculated on the basis of the amounts that are available for investment after deduction of all costs borne by the investors.

14. Are there borrowing restrictions or conditions for retail funds? If so, what are they?

### **Open-ended retail funds**

A UCITS can only take out short-term loans:

- Up to a limit of 10% of the asset value of the fund.
- Where the borrowing conditions are in line with market conditions.
- Where borrowing is provided for in the investment guidelines.

The same borrowing restriction applies to:

- Mixed investment funds.
- Funds of funds.
- Real estate contractual funds.

For other investment funds a limit of 20% applies.

Real estate contractual funds can take out and hold loans if:

- This is provided for in the investment guidelines
- The borrowing is compatible with proper management.
- The borrowing conditions are in line with market conditions.
- The total encumbrance of the fund's assets does not exceed 30% of the market value of the fund's real property.

Borrowing at the level of real estate companies in which the fund is invested is taken into account on a pro rata basis according to the amount of the fund's participation. Borrowing to finance redemption of units is only permissible with short-term loans up to a limit of 10% of the asset value of the fund.

## Closed-ended retail funds

Borrowing for a closed-ended retail fund is limited to 150% of the subscribed capital calculated on the basis of the amounts that are available for investment after deduction of all costs borne by the investors. It is only permitted if the borrowing conditions are in line with market conditions and borrowing is provided for in the investment guidelines.

Borrowing at the level of companies holding real assets or assets required for the management of such real assets in which the fund holds a participation is taken into account on a pro rata basis according to the amount of the fund's participation. The total encumbrance of the fund's assets must not exceed 150% of the subscribed capital calculated on the basis of the amounts that are available for investment after deduction of all costs borne by the investors.

These borrowing restrictions do not have to be complied with during the initial fundraising. However, the fund must be in compliance with these borrowing restrictions no later than 18 months after the start of distribution.

## Redemption of interests

15. Can participants redeem their interest? Can the manager or operator place any restrictions on the issue and redemption of interests in retail funds? Are there any restrictions on the rights of participants to transfer or assign their interests to third parties?

## Open-ended retail funds

**Restrictions on redemption of interests.** Generally, investors in an open-ended fund must be granted the right to redeem their interests at least twice a month. The investment guidelines may require investors to observe a redemption period. This period must not exceed one month.

The management company may restrict the redemption for a period of maximum 15 working days if investors' requests for redemption reach a previously defined threshold above which, due to the liquidity situation of the fund's assets, the redemption request can no longer be executed in the interest of all investors (redemption gate).

Redemption may also be suspended if exceptional circumstances arise that, taking into account the investors' interest, make a suspension necessary. Fund units cannot be issued while redemption is suspended.

Certain derogations from the general provisions regarding redemption frequency and redemption period apply for retail AIFs in the form of other investment funds and funds of hedge funds. However, redemption must always take place at least once a year.

Redemption of units in a real estate contractual fund is only possible after a minimum vesting period of 24 calendar months. Redemption must take place at least every 12 months and investors must observe a redemption period of 12 months. The management company must suspend redemption if and for as long as the fund's cash and liquid assets are insufficient to pay the redemption price and to ensure a proper management of the fund's assets on an ongoing



basis. This suspension can last up to 36 months. During the suspension, the management company must sell fund assets at conditions specified in the KAGB in order to procure the funds necessary for the redemption of units.

There are generally no requirements regarding the issue of fund interests. The management company can restrict the issue of fund interests at its discretion. The issue of units must be temporarily suspended if a breach of the fund's investment restrictions is imminent.

**Restrictions on rights to transfer or assign interests to third parties.** The transfer of fund units or shares is not restricted by law.

Shares of an investment stock corporation are only subject to a transfer restriction if they are issued in registered form, in which case any transfer of shares is subject to the consent of the company. Bearer shares cannot be subject to a transfer restriction. However, in practice, both shares and units in retail funds are issued to investors in bearer form.

Investment guidelines of contractual investment funds do not typically contain any transfer restrictions. Some funds may require a transfer restriction for tax purposes, for example, tax privileged funds that are acquired by the investor in the context of retirement provisions or annuity contracts.

Where the fund's investment guidelines require investors to observe a redemption period, fund interests are blocked for transfer or assignment once the investor has irrevocably declared a redemption request to the fund's management company.

## Closed-ended retail funds

**Restrictions on redemption of interest.** Closed-ended retail funds generally do not offer redemptions.

**Restrictions on rights to transfer or assign interests to third parties.** Unless otherwise provided for in the partnership agreement, the transfer of a limited partner interest to a third party is subject to the approval of all partners. In derogation from this legal principle, the partnership agreements of closed-ended investment limited partnerships typically provide that investors' rights to transfer their limited partner interests are subject to the approval of the fund's management company, which can be only withheld in cases specified in the partnership agreement or on substantial grounds.

A transfer restriction for shares in an investment stock corporation is only possible for shares that are issued in registered form (*see above, [Open-ended retail funds](#)*).

Generally, the tradability of limited partner interests or shares is limited because there is no established secondary market for trading with participations in closed-ended funds.

## Reporting requirements



16. What are the general periodic reporting requirements for retail funds?

## Open-ended retail funds

**Investors.** For each UCITS or retail AIF, a semi-annual and annual report must be drawn up, published in the German Federal Gazette (*Bundesanzeiger*) and made available to investors.

Under the AIFM Directive and Articles 109, 109 of the AIFM Deregulated Regulation, AIFMs must also disclose to investors at least annually for any AIF they manage information about the fund's:

- Liquidity management.
- Risk profile and risk management systems.
- Leverage.

Disclosure is typically made in the annual report.

The fund's issue and redemption price and NAV per share or unit must be published on each issue or redemption of units or shares, but at least twice a month, in:

- A business publication or daily newspaper with sufficient circulation.
- The sales prospectus.
- Electronic media specified in the Key Investor Information Document (KIID).

Certain retail AIFs may have lower frequencies in accordance with their procedures for the issuance or redemption of fund interests.

**Regulators.** UCITS management companies must report to BaFin annually for each German UCITS they manage on their use of:

- Derivatives.
- Structured products with a derivative component.
- Securities lending.
- Repo transactions.

AIFMs must report to BaFin regularly on any AIF they manage in accordance with the requirements of the AIFM Directive and Article 110 of the AIFM Deregulated Regulation (Annex IV reporting).

The fund's semi-annual and annual report must be submitted to BaFin. Annual reports must be audited by an external auditing firm. The audit report is submitted to BaFin.

Monthly statistical reports must be submitted to the German Federal Bank for every fund.

## Closed-ended retail funds

**Investors.** The annual report of a closed-ended fund must be made available to investors at a place specified in the sales prospectus or KIID.

The disclosure requirements for AIFMs of open-ended funds in relation to liquidity management, risk profile and risk management systems and leverage also apply to AIFMs managing closed-ended retail funds.

The NAV per limited partner interest or share must be calculated in accordance with Articles 67 to 73 of the AIFM Deregulated Regulation and disclosed to investors at least once a year in the media specified in the investment guidelines.

**Regulators.** AIFMs of closed-ended AIFs must comply with the Annex IV reporting requirement in relation to each fund (see above, *Open-ended retail funds*).

An annual report must be drawn up for each fund, published in the German Federal Gazette and submitted to BaFin. The annual report must be audited by an external auditor. The audit report is submitted to BaFin.

Closed-ended funds are also subject to the monthly statistical reporting to the German Federal Bank.

## Tax treatment

17. What is the tax treatment for retail funds?

For many retail funds, the special tax regime of the German Investment Tax Act (*Investmentsteuergesetz*) applies, which came into force in 2018. This regime generally classifies investment funds as opaque entities that are subject to German corporate income tax (*Körperschaftsteuer*) on certain German-sourced income. German resident investors are taxed on distributions, an annual imputed interest amount and capital gains, but may qualify for certain partial tax exemptions.

This special tax regime applies to open-ended and closed-ended funds. However, it does not apply to funds structured as partnerships unless the partnership qualifies as a UCITS. For AIF partnerships, the general rules of German partnership taxation apply.

## Open-ended retail funds

**Funds.** If the fund is established as a corporation, a contractual investment fund or a UCITS, the German Investment Tax Act applies. Under this regime, German and non-German investment funds are generally subject to corporate income tax at a rate of 15% on certain German-sourced income, including dividends and real estate related income, but generally excluding capital gains. Such investment funds are exempt from trade tax (*Gewerbesteuer*)

unless they actively engage in certain trade or business activities (such as high-frequency trading, engaging in the management of portfolio companies, or renting in a hotel-like manner).

**Resident investors.** Distributions by the fund, an annual imputed interest amount and capital gains from the sale of fund units ("investment income") are taxable at the level of German resident investors. A tax-exempt repayment of capital is generally not possible.

Individuals are subject to income tax (*Einkommensteuer*) on investment income at their individual tax rate of up to approximately 47.5%. Individuals holding units as business assets are also subject to trade tax at between 7% and 17% (depending on the municipality). However, this is creditable against their income tax burden (subject to certain limitations). Corporations are subject to corporate income tax of approximately 16% and (non-creditable) trade tax on investment income.

Depending on the type of fund (equity fund, mixed fund or domestic/non-domestic real estate fund) and the type of investor (private individual, individual holding units as business assets or corporations), certain partial exemptions (*Teilfreistellungen*) of up to 80% may apply. The classification of a fund depends on the composition of its assets. For example, for an equity fund:

- A 30% tax exemption from income tax applies to private individuals.
- A 60% exemption applies to individuals holding units as business assets.
- An 80% exemption from corporate income tax applies to corporations.

For trade tax purposes the tax exemption is reduced by half.

Investment income generally is subject to withholding tax. In the withholding procedure only the partial exemption rate for private individuals is taken into account, and a higher exemption must be claimed in the tax assessment procedure.

**Non-resident investors.** Non-resident investors are generally not subject to German taxation with respect to their investment income.

## Closed-ended retail funds

**Funds.** For funds set-up as a corporation or a contractual investment fund or UCITS, see above, [Open-ended retail funds](#).

If the fund is established as an AIF partnership, the general rules for the taxation of partnerships apply.

Generally, partnerships are tax transparent for German (corporate) income tax purposes and therefore only the partners are subject to German (corporate) income tax on their allocable share of profits realised by the partnership.

For trade tax purposes, partnerships are only tax transparent if they do not qualify as being engaged in a trade or business. If they are engaged in a trade or business, their profits are subject to trade tax at fund level, with certain exemptions being applicable for capital gains and dividends, depending on the tax status of its partners and, in case of dividends, on whether the fund holds at least 15% in the distributing company.

Distributions by the partnership to the investors are not subject to taxation.

**Resident investors.** German individual investors are subject to income tax on their allocable share of the fund's profits.

If the partnership is not engaged in a trade or business, dividends, interest payments and capital gains are taxed at the individual investors' level at a flat rate of approximately 26% or (where the investor holds the interest in the fund as a business asset) at the investor's individual income tax rate, with a 40% exemption for dividends and capital gains. Trade tax is levied on individual investors holding their interest as a business asset but is creditable against the income tax burden (subject to certain limitations).

If the partnership is engaged in a trade or business, the partners' allocable share is subject to income tax at the individual investors' level at their individual income tax rate, with a 40% exemption for dividends and capital gains. However, no trade tax is levied against the investor (as the fund itself is subject to trade tax).

German corporate investors are subject to corporate income tax at a rate of approximately 16% on their allocable share of the fund's profits and (non-creditable) trade tax unless the fund itself is subject to trade tax. An effective 95% tax exemption is applicable for capital gains from the disposition of shares in corporations. For dividends, the exemption is applicable only if the investor, on a look-through basis, holds at least 10% (corporate income tax) or 15% (trade tax) in the distributing company.

Dividends from German corporations are subject to a withholding tax of approximately 26%, which is generally creditable against the investor's (corporate) income tax burden. Withholding tax only applies to:

- Capital gains on shares collectively deposited at a financial institution.
- Interest payments if paid by a financial institution or originating from profit participating loans.

**Non-resident investors.** In the case of a partnership, non-resident investors are subject to German (corporate) income tax on their entire allocable share of the fund's profits and must file tax returns if the German fund is engaged in a trade or business. Otherwise, non-resident investors are generally only subject to German (corporate) income tax on income from certain German sources, including:

- Dividends.
- Interest on certain debt instruments.
- Capital gains where the investor has held more than 1% in the corporation within a five-year period.

Certain exemptions and reductions may apply under domestic tax law and pursuant to double tax conventions. In particular, double tax conventions often assign the right to tax capital gains exclusively to the state of the taxpayer's residency.

Withholding taxes generally apply as outlined above but may be (partly) refunded to the investor, subject to certain requirements and exceptions, in particular where double tax conventions limit Germany's right to tax such income.

## Reform

18. What proposals are there (if any) for the reform of retail fund regulation?

No major reforms are currently being planned or discussed.

In December 2020, the German Federal Ministry of Finance issued a draft law to strengthen Germany as fund location, which, among other things, allows infrastructure funds to be set up as open-ended retail funds in contractual form.

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#### Publications

- *"Germany Private Equity Rebounds Defiantly", Private Equity International (December, 2020)*
- *"Keeping an eye on sustainability goals in times of the corona crisis", Börsen-Zeitung (March, 2020)*
- *"Private Funds CFO: What EU ESG rule delays mean for investment funds", Private Funds CFO (October, 2019)*

- *"Brexit Roundtable", Real Deals (January, 2019)*

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